

**LETTER FROM THE AUDITOR OF PUBLIC ACCOUNTS
DEPARTMENT OF EDUCATION**

**In Reference to the Statewide Single Audit
of the Commonwealth of Kentucky**

For the Year Ended June 30, 2003



**CRIT LUALLEN
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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

Gene Wilhoit, Commissioner
Department of Education

MANAGEMENT LETTER

Pursuant to KRS 43.090 (1), which states, "[i]mmediately upon completion of each audit and investigation, except those provided for in KRS 43.070, the Auditor shall prepare a report of his findings and recommendations," we are providing this letter to the Department of Education to comply with KRS 43.090.

The work completed on the Department of Education is part of the overall opinions included in the audit of the Commonwealth of Kentucky's Comprehensive Annual Financial Report (CAFR) and Statewide Single Audit. Findings and recommendations for agencies, if applicable, audited as part of the CAFR and Single Audit can be found in the Statewide Single Audit Report. This report can be obtained on our website at www.kyauditor.net. If our audit noted Other Matters related to the Department of Education, which we believe should be reported to management, those are included in this letter.

Included in the Department of Education's letter are the following:

- ◆ Acronym List
- ◆ Schedule of Expenditures of Federal Awards
- ◆ Notes to the Schedule of Expenditures of Federal Awards
- ◆ Other Matters to Report to Management

Thank you for the cooperation shown our audit staff during the course of your audit. If you have any questions, please contact Michelle Sutton, Audit Manager, at (502)573-0050 or email at michelle.sutton@auditor.ky.gov, or me.

Respectfully submitted,

A handwritten signature in cursive script, reading "Crit Luallen".

Crit Luallen
Auditor of Public Accounts

LIST OF ABBREVIATIONS/ACRONYMS USED IN THIS REPORT

APA	Auditor of Public Accounts
BG-1	Building and Grounds Application
CFDA	Catalog of Federal Domestic Assistance
Commonwealth	Commonwealth of Kentucky
ED	Department of Education
FY	Fiscal Year
IDEA-B	Individuals with Disabilities Education Act, Part B
KDE	Kentucky Department of Education
KRS	Kentucky Revised Statutes
LEA	Local Educational Agency
MARS	Management Administrative Reporting System
MRDB	Management Reporting Database
MUNIS	Municipal Information System
OMB	Office of Management and Budget
RCW	Record of Control Weakness
SEFA	Schedule of Expenditures of Federal Awards

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SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

CFDA #	Program Title	Expenditures		Provided to Subrecipient
		Cash	Noncash	
DEPARTMENT OF EDUCATION				
U.S. Department of Agriculture				
Direct Programs:				
Child Nutrition Cluster:				
10.553	School Breakfast Program (Note 2)	\$	31,105,721	\$ 31,020,020
10.555	National School Lunch Program (Note 2)		96,325,008	96,156,294
10.556	Special Milk Program for Children (Note 2)		93,914	93,914
10.559	Summer Food Service Program for Children (Note 2)		4,532,272	4,393,458
10.558	Child and Adult Care Food Program (Note 2)		25,044,722	24,658,415
10.560	State Administrative Expenses for Child		1,756,228	0
Passed Through From Cabinet for Workforce Development:				
17.259	WIA Youth Activities		946,703	831,246
U.S. Department of Education				
Direct Programs:				
84.010	Title I Grants to Local Educational Agencies (Note 2)		129,061,216	124,358,284
84.011	Migrant Education - State Grant Program		6,962,780	6,812,806
84.013	Title I Program for Neglected and Delinquent Children		9,276	0
Special Education Cluster:				
84.027	Special Education - Grants to States (Note 2)		97,583,762	94,291,280
84.173	Special Education - Preschool Grants (Note 2)		10,923,826	9,510,745
84.162	Immigrant Education		332,790	325,939
84.185	Byrd Honors Scholarships		527,695	0
84.186	Safe and Drug-Free Schools and Communities-State Grants		4,858,961	4,803,160
84.194	Bilingual Education Support Services		25,298	0
84.196	Education for Homeless Children and Youth		657,306	651,777
84.213	Even Start: State Educational Agencies		2,979,973	2,752,575
84.215	Fund For The Improvement of Education		14,108	0
84.216	Capital Expenses		65,256	65,256
84.276	Goals 2000 - State and Local Education Systemic Improvement Grant		164,035	7,878
84.281	Eisenhower Professional Development State Grants		4,304,463	3,850,351
84.287	Twenty-First Century Community Learning Centers		2,145,074	2,107,721
84.293	Foreign Language Assistance		60,064	13,306
84.298	Innovative Education Program Strategies		3,748,020	3,517,053
84.314	Even Start: Statewide Family Literacy Program		270,499	0
84.318	Education Technology State Grants		1,231,722	1,050,470
84.323	Special Education: State Program Improvement Grants for Children with Disabilities		543,421	523,606

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

CFDA #	Program Title	Expenditures		Provided to Subrecipient
		Cash	Noncash	
84.326	Special Education: Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	66,631		54,684
84.330	Advanced Placement Program	546,432		126,544
84.332	Comprehensive School Reform Demonstration	3,847,136		3,720,368
84.338	Reading Excellence	1,415,957		1,354,621
84.340	Class Size Reduction	10,261,862		10,261,860
84.348	Title I Accountability Grants	2,785,212		2,785,211
84.352	School Renovation Grants	8,800,000		8,800,000
84.358	Rural Education	1,789,292		1,789,292
84.365	English Language Acquisition Grants	366,403		365,351
84.367	Improving Teacher Quality State Grants	11,459,257		11,434,831
84.369	Grants for State Assessments and Related Activities	4,565,332		69,801
Passed Through From Cabinet for Workforce Development:				
84.048	Vocational Education - Basic Grants to States	6,044,070		5,806,209
<u>U.S. Department of Health and Human Services</u>				
Direct Programs:				
93.576	Refugee and Entrant Assistance: Discretionary Grants	310,573		308,329
93.938	Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	235,255		136,648
Passed Through From Cabinet for Health Services				
93.945	Assistance Programs for Chronic Disease Prevention and Control	272,711		251,666
<u>U.S. Corporation for National and Community Service</u>				
Direct Programs:				
94.004	Learn and Serve America: School and Community Based Programs	417,411		386,017
TOTAL DEPARTMENT OF EDUCATION		\$ 479,457,647	\$ -	\$ 459,446,986

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

Note 1 - Purpose of the Schedule and Significant Accounting Policies

Basis of Presentation - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*. The accompanying schedule includes all federal grant activity for the Commonwealth, except those programs administered by state universities, and is presented primarily on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. The Commonwealth elected to exclude state universities from the statewide single audit, except as part of the audit of the basic financial statements.

KRS 45.229 provides that the Finance and Administration Cabinet may, “for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

The basic financial statements of the Commonwealth are presented on the modified accrual basis of accounting for the governmental fund financial statements and the accrual basis of accounting for the government-wide, proprietary fund, and fiduciary fund financial statements. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

Clusters of programs are indicated in the schedule by light gray shading.

Inter-Agency Activity - Certain transactions relating to federal financial assistance may appear in the records of more than one (1) state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of the schedule:

- (a) Federal moneys may be received by a state agency and passed through to another state agency where the moneys are expended. Except for pass-throughs to state universities as discussed below, this inter-agency transfer activity is reported by the agency expending the moneys.

State agencies that pass federal funds to state universities report those amounts as expenditures.

- (b) Federal moneys received by a state agency and used to purchase goods or services from another state agency are reported in the schedule as an expenditure by the purchasing agency only.

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

Note 2 - Type A Programs

Type A programs for the Commonwealth mean any program for which total expenditures of federal awards exceeded \$18 million for FY 03. The Commonwealth had the following programs (cash and noncash) that met the Type A program definition for FY 02, some of which were administered by more than one (1) state agency. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds. The Commonwealth identified clusters among the Type A programs by gray shading. These Type A programs and clusters were:

CFDA #	Program Title	Expenditures
Child Nutrition Cluster:		
10.553	School Breakfast Program	\$ 31,105,721
10.555	National School Lunch Program	96,325,008
10.556	Special Milk Program for Children	93,914
10.559	Summer Food Service Program for Children	4,532,272
10.558	Child and Adult Care Food Program	25,044,722
84.010	Title I Grants to Local Educational Agencies	129,061,216
Special Education Cluster:		
84.027	Special Education - Grants to States	97,583,762
84.173	Special Education – Preschool Grants	10,923,826
Total Type A Programs		<u>\$ 394,670,441</u>

FEDERAL AWARD FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 03-EDU-1: The Department Of Education Should Document Adequate Support For Expenditures Prior To Reimbursing Subrecipients**

State Agency: Kentucky Department of Education

Federal Program: School Renovation Grants

Federal Agency: U.S. Department of Education

Pass-Through Agency: Not Applicable

Compliance Area: Cash Management

Amount of Questioned Costs: Not Applicable

During expenditure testing for the School Renovation Grant, there were amounts without adequate support or support was received after the payment date. We reviewed invoices supporting the reimbursement of expenditures to the Local Educational Agencies (LEA) for the School Renovation Grant. In one case, the Caverna LEA was given \$50,000 in September 2002, but the invoices supporting this payment were dated between October 2002 and June 2003.

In another instance, the Monroe LEA requested reimbursement for \$107,985.20 and was given \$108,072 (the full grant amount). The support for the difference of \$86.80 was not documented in the file.

Without obtaining invoices or other support prior to providing federal funds, the LEAs could be spending the federal funds for purposes not allowed by the federal grant award.

Per the OMB Circular A-133 Compliance Supplement Cash Management Section, "When entities are funded on a reimbursement basis, program costs must be paid by entity funds before reimbursement is requested from the Federal Government."

Recommendation

We recommend KDE:

- Obtain invoices or other support for LEA expenditures prior to providing the LEAs with federal funds.
- Document the reason an amount other than the requested amount was provided to an LEA and obtain supporting documentation for any differences.

FEDERAL AWARD FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 03-EDU-1: The Department Of Education Should Document Adequate Support For Expenditures Prior To Reimbursing Subrecipients (Continued)****Management's Response and Corrective Action Plan**

The Department of Education fully understands the findings presented in this RCW and agree with the recommendations. Below is a plan for corrective action, submitted by the Administrative Branch Manager in the Division of Pupil Transportation, to assure that the proper documentation to support grant payments is maintained. These processes will be put into place immediately.

It was determined by the review team of the Emergency School Renovation & Repair, IDEA-B and Technology Grant, that recipients would receive an initial payment of up to \$250,000 with an approved BG-1 (Building & Grounds Application) submitted to the Division of Facilities Management. This decision was supported by the rigorous guidelines that districts must follow, including state statutes and regulations, in order to meet the approval of the division. In this particular incident, Caverna Independent submitted an approved BG-1 for the renovation portion of the grant, as well as a MUNIS report, detailing the IDEA-B expenditures. The individual responsible for approval of payment inadvertently picked up the budgeted amount instead of the actual expenditure amount for payment. Immediately following recognition of this isolated incident, the district was contacted for further supporting documentation.

Corrective Action Plan: In order to avoid the potential of future errors, a second individual will be included in the review for payment processing to ensure accurate payment of funds and adequate documentation.

With regard to full payment of \$108,072.00 to Monroe County with only supporting documentation of \$107,985.20, the reviewer felt the difference of \$86.80 represented .0008 of 1% of the total and considered immaterial relative to the amount of paperwork and staff time required to support payment of the additional amount. Monroe County will be contacted and requested to submit an invoice for the payment of \$86.80. Qualified expenditures by the sub-recipient will certainly equal or exceed the full amount of their award. Therefore, it is more efficient and cost effective to adjust their request to the full amount of the award.

Correction Action Plan: In the future, any adjustments to the request for reimbursement (invoice) from a sub-recipient will be noted and explained in the documentation supporting the payment.

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 03-EDU-2: The Department Of Education Should Adequately Follow All Instructions For The Preparation Of The Schedule Of Expenditures Of Federal Awards**

State Agency: Kentucky Department of Education

Federal Program: Various

Federal Agency: Various

Pass-Through Agency: Not Applicable

Compliance Area: Not Applicable

Amount of Questioned Costs: Not Applicable

KDE is not adequately following the instructions for the preparation of the SEFA with accompanying notes and the Schedule of Subrecipients. The APA provides to all state organizations annually the instructions for the preparation of the SEFA and its required reports. The adherence to these instructions assists the KDE as well as the Commonwealth, with compliance to OMB-A-133.

During the audit of KDE's SEFA, the following were noted:

- SEFA was not reconciled to the Management Reporting Database (MRDB).
- Pass-through receipts and expenditures did not agree with other agencies' reported amounts.
- Transfer activity was reported as receipts or expenditures.
- SEFA notes were disclosed that were not in agreement with the SEFA.
- SEFA notes were disclosed that did not apply to the agency.
- Schedule of Subrecipients contained payments to other state agencies and interfund transfers.
- Incorrect federal granting agency was listed for some CFDA's on the SEFA.

There were similar problems noted in KDE's SEFA in the FY 02 audit as well, and those were reported to KDE only as a recommendation last year. We have not seen improvement in the FY 03 SEFA.

When the SEFA is not prepared in accordance with APA instructions, there could be several unfavorable results:

- It leaves open the possibility of incorrect information being reported in MRDB and/or incorrect or inaccurate information presented in the SEFA.
- The SEFA may not correspond with other agency schedules reporting pass-throughs to and from the ED.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 03-EDU-2: The Department Of Education Should Adequately Follow All Instructions For The Preparation Of The Schedule Of Expenditures Of Federal Awards (Continued)

- Transfer activity may not be differentiated from other receipts and expenditures, thus overstating/understating the amounts.
- The SEFA notes may not agree and may not apply to the SEFA.
- The Schedule of Subrecipients will not be reported correctly.
- Federal granting agencies will not be listed correctly on the SEFA.

Without completely following the instructions and performing a thorough review, KDE is not presenting the most accurate SEFA, accompanying SEFA Notes, and Schedule of Subrecipients to the APA.

Reconciliation

- The APA's SEFA instructions state:

Information contained in the schedule should be reconciled to the Management Reporting Database (MRDB), an extract of Management Administrative Reporting System (MARS) information, with documentation of the reconciliation retained. This will ensure the SEFA agrees to the official accounting records of the Commonwealth, which will have been agreed to the Commonwealth's basic financial statements.

If your agency does not operate through MARS, the schedule should be reconciled to the agency accounting system supporting your agency's financial statements.

This reconciliation should encompass both receipts and expenditures, and should be done on a grant-by-grant basis, if possible.

- The APA SEFA instructions state and KDE's Management Representation letter (dated August 28, 2003) represent the following:

We have reconciled information contained in the Schedule of Expenditures of Federal Awards – cash programs to the Management Administrative Reporting System and Management Reporting Database.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 03-EDU-2: The Department Of Education Should Adequately Follow All Instructions For The Preparation Of The Schedule Of Expenditures Of Federal Awards (Continued)

Pass Throughs

- The APA's SEFA instructions state:

Column F - Passed throughs from other agencies (including revenue redistributions) should consist of federal moneys received from other federal grants (either from inside the agency or from another state agency) to fund federal expenditures. When an agency is a subrecipient of another state agency, those moneys received should be shown in this column. If you are not able to determine if you are considered a subrecipient or a vendor, it may be necessary to contact the other state agency to determine their treatment of the transaction(s).... Column J - pass throughs to other agencies (including revenue redistributions) should consist of moneys distributed from the grant to other federal grants (either to inside the agency or to another state agency) to fund federal expenditures. Passed through amounts between grants within the same agency must agree. Payments made to state agencies, even if made electronically, except to state universities, would be shown in this column (J). Report federal moneys to a state university subrecipient as an expenditure in Column H.

All amounts in these columns (F & J) must be explained in the Notes.

Transfers

- Good internal controls dictate that transfers between funds not be recorded as receipts or expenditures on the SEFA since a transfer is not a receipt or an expenditure of federal awards.

SEFA Notes

- The APA's SEFA instructions state:

All amounts reported on SEFA 2 - Cash Programs for Passed Through From Other Agencies /Revenue Redistributions (Column F), Other Additions (Column G), Paid To Grantor (Column I), Passed Through To Other Agencies /Revenue Redistributions (Column J), and Other Deductions (Column K) must be listed in the notes. Add additional notes to disclose any condition which could be material to, or would enhance the presentation of, your agency's SEFA.

- In addition, internal controls over the SEFA preparation include ensuring that the SEFA notes are consistent with and support the information presented in the SEFA. Any disclosures not relating to the agency's SEFA should be eliminated.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 03-EDU-2: The Department Of Education Should Adequately Follow All Instructions For The Preparation Of The Schedule Of Expenditures Of Federal Awards (Continued)

Schedule of Subrecipients

- The APA's SEFA instructions also state that the Schedule of Subrecipients:
 - . . . Should include subrecipients, such as local governments, school or special districts, nonprofit organizations, etc., and universities. Do not include state agencies on this schedule. Money sent to or received from other state agencies, except universities, appears on SEFA 2 under the pass through to/from columns and on SEFA 5 under Notes 2 and 3.

Incorrect Federal Grantor Identification

- Circular A-133 Subpart C §.300(a) requires that the federal program and award identification on the SEFA include the CFDA title and number, the award number and year, the name of the federal granting agency, and the name of the pass-through entity.

Recommendation

We recommend that KDE:

- Reconcile the SEFA to the MRDB prior to submitting it to the APA to ensure that both the SEFA and the MRDB are accurate and complete.
- Provide the APA with the written reconciliation of the SEFA with the MRDB at the beginning of the audit.
- Compare pass-through receipts and expenditures with the pass-through amounts recorded and reported by other agencies.
- Not include transfer activity as receipts or expenditures on the SEFA.
- Review the SEFA notes to ensure that they are in agreement with the information presented in the SEFA.
- Review the SEFA notes to ensure they apply to the KDE.
- Exclude payments to other state agencies and interfund transfers from the Schedule of Subrecipients.
- Compare the federal granting agency with the CFDA listing at <http://www.cfda.gov/> to ensure they are properly identified on the SEFA.

Finally, we recommend that KDE review and follow the APA instructions for the preparation of the SEFA, Notes to the SEFA, and the Schedule of Subrecipients and perform adequate reviews prior to submission.

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 03-EDU-2: The Department Of Education Should Adequately Follow All Instructions For The Preparation Of The Schedule Of Expenditures Of Federal Awards (Continued)**

Management's Response and Corrective Action Plan

1. *THE SEFA WAS NOT RECONCILED WITH MARS – The Financial Analyst will contact the Auditor's Office immediately to request a final 2003 State Audit to use in verifying ending 2003 balances and beginning 2004 balances. The Financial Analyst will also work with the Director to produce a monthly grant summary report to use in reconciling the SEFA to the MRDB prior to submitting the 2004 SEFA to the APA to ensure both the SEFA and the MRDB are accurate and complete. The Administrative Branch Manager and the Director will review this written reconciliation for accuracy and completeness prior to submission. After review, the Associate Commissioner will submit the SEFA and written reconciliation to APA.*
2. *PASS THROUGH RECEIPTS & EXPENDITURES DID NOT AGREE WITH SECONDARY AGENCY CFDAS – The Financial Analyst will compile a list of contacts for secondary agencies and confirm in writing that the pass-through amounts are correct. The Financial Analyst will investigate any differences and maintain written confirmation with the SEFA backup documentation and support. This will begin January 26, 2004.*
3. *TRANSFER ACTIVITY SHOULD NOT BE REPORTED AS REVENUES/EXPENDITURES – The Financial Analyst will continue to report transfer activity in the 99999-99 section of the 7240 report and will also ensure that all prior year transfers are reversed in the current year, and will not report the transfers as receipts or expenditures on the SEFA.*
4. *INCORRECT PROGRAM/GRANTOR NAMES IN THE SEFA – Beginning in February 2004, The Administrative Branch Manager and Administrative Specialist will compare program names, etc., with the CFDA website to ensure all Federal Program Names, Grantors and CFDA #'s are listed accurately and completely and update SEFA forms accordingly.*
5. *OTHER ITEMS – Also beginning in February, the Administrative Specialist will delete the "Total All Programs" line from all pages except the final page to prepare the forms for 2004.*

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 03-EDU-2: The Department Of Education Should Adequately Follow All Instructions For The Preparation Of The Schedule Of Expenditures Of Federal Awards (Continued)**

Management's Response and Corrective Action Plan (Continued)

6. *SEFA NOTE DISCLOSURE TOTALS DID NOT AGREE WITH THE SEFA TOTALS – The Administrative Branch Manager and Administrative Specialist will run manual totals on the SEFA Note amounts to compare with the SEFA and to verify accuracy of both the Notes and SEFA prior to the submission of the 2004 report.*
7. *NOTE DISCLOSURES WERE MADE THAT DID NOT APPLY TO THE FY'03 SEFA – The Financial Analyst and Administrative Specialist will make sure any Notes listed that do not apply to KDE are so documented (e.g., Note 1KDE does not have any non-cash programs.) This will be done prior to submission of 2004 SEFA.*
8. *GRANT AND AGENCY NAMES WERE NOT CORRECT IN THE NOTES – The Administrative Branch Manager and Administrative Specialist will verify all grant and agency names listed in the Notes by comparing to those listed on the CFDA website. This will begin in February 2004.*
9. *EXCLUDE PAYMENTS TO OTHER STATE AGENCIES AND INTERFUND TRANSFERS ON THE SCHEDULE OF SUBRECIPIENTS – The financial report that is used for the schedule of subrecipients will be modified to exclude payments to other agencies, interfund transfers and any other transactions that not a pass-through of funds to a subrecipient. This change will be implemented immediately.*

